International Business Environments and Operations, 13/e

Part Three
Theories and Institutions: Trade and Investment



Chapter Six

International Trade and Factor Mobility Theory

Chapter Objectives

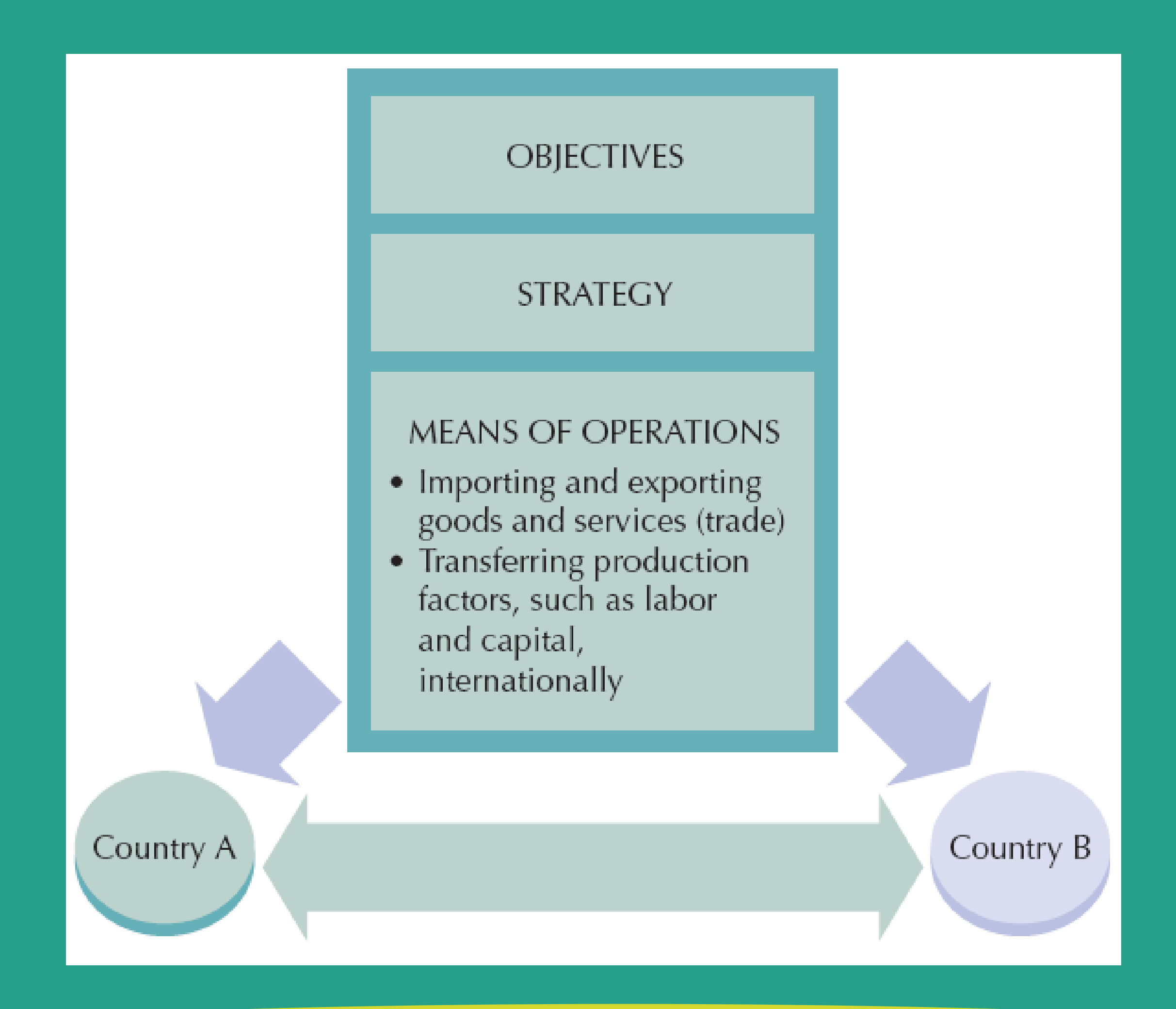
- To understand theories of international trade
- To explain how free trade improves global efficiency
- To identify factors affecting national trade patterns
- To explain why a country's export capabilities are dynamic
- To understand why production factors, especially labor and capital, move internationally
- To explain the relationship between foreign trade and international factor mobility

Trade Theory

Helps managers and government policymakers focus on these questions:

- What products should we import and export?
- How much should we trade?
- With whom should we trade?

International Operations and Economic Connections



What the major trade theories Do and Don't discuss

	DESCRIPTION OF NATURAL TRADE			PRESCRIPTION OF TRADE RELATIONSHIPS			
THEORY	HOW MUCH IS TRADED?	WHAT PRODUCTS ARE TRADED?	WITH WHOM DOES TRADE TAKE PLACE?	SHOULD GOVERNMENT CONTROL TRADE?	HOW MUCH SHOULD BE TRADED?	WHAT PRODUCTS SHOULD BE TRADED?	WITH WHOM SHOULD TRADE TAKE PLACE?
Mercantilism	—	—	—	yes	✓	✓	✓
Neomercantilism	—	—	—	yes	✓	—	—
Absolute advantage	—	✓	—	no	—	✓	—
Comparative advantage	—	✓	—	no	—	✓	—
Country size	✓	✓	—	—	—	—	—
Factor proportion	—	✓	✓	—	—	—	—
Country similarity	—	✓	✓	—	—	—	—
Product life cycle (PLC)	—	✓	✓	—	—	—	—
Porter diamond	—	✓	—	—	—	—	—

Interventionist Theories

- Mercantilist theory proposed that a country should try to achieve a favorable balance of trade (export more than it imports)
- Neomercantilist policy also seeks a favorable balance of trade, but its purpose is to achieve some social or political objective

Free Trade Theories

- Absolute Advantage
  - Suggests specialization through free trade because consumers will be better off buying foreign-made products priced more cheaply than domestic ones
- Comparative Advantage
  - Also proposes specialization through free trade based on the belief that total global output can increase even if one country has an absolute advantage in the production of all products

Theories of Specialization

- Both absolute and comparative advantage theories are based on specialization
- Assumptions policymakers question:
  - full employment
  - economic efficiency
  - division of gains
  - two countries, two commodities
  - transport costs
  - statics and dynamics
  - services
  - production networks
  - mobility

Trade Pattern Theories

- Theory of Country Size
- Factor-Proportions Theory
- Country Similarity Theory
- Product Life Cycle Theory
- Diamond of National Advantage

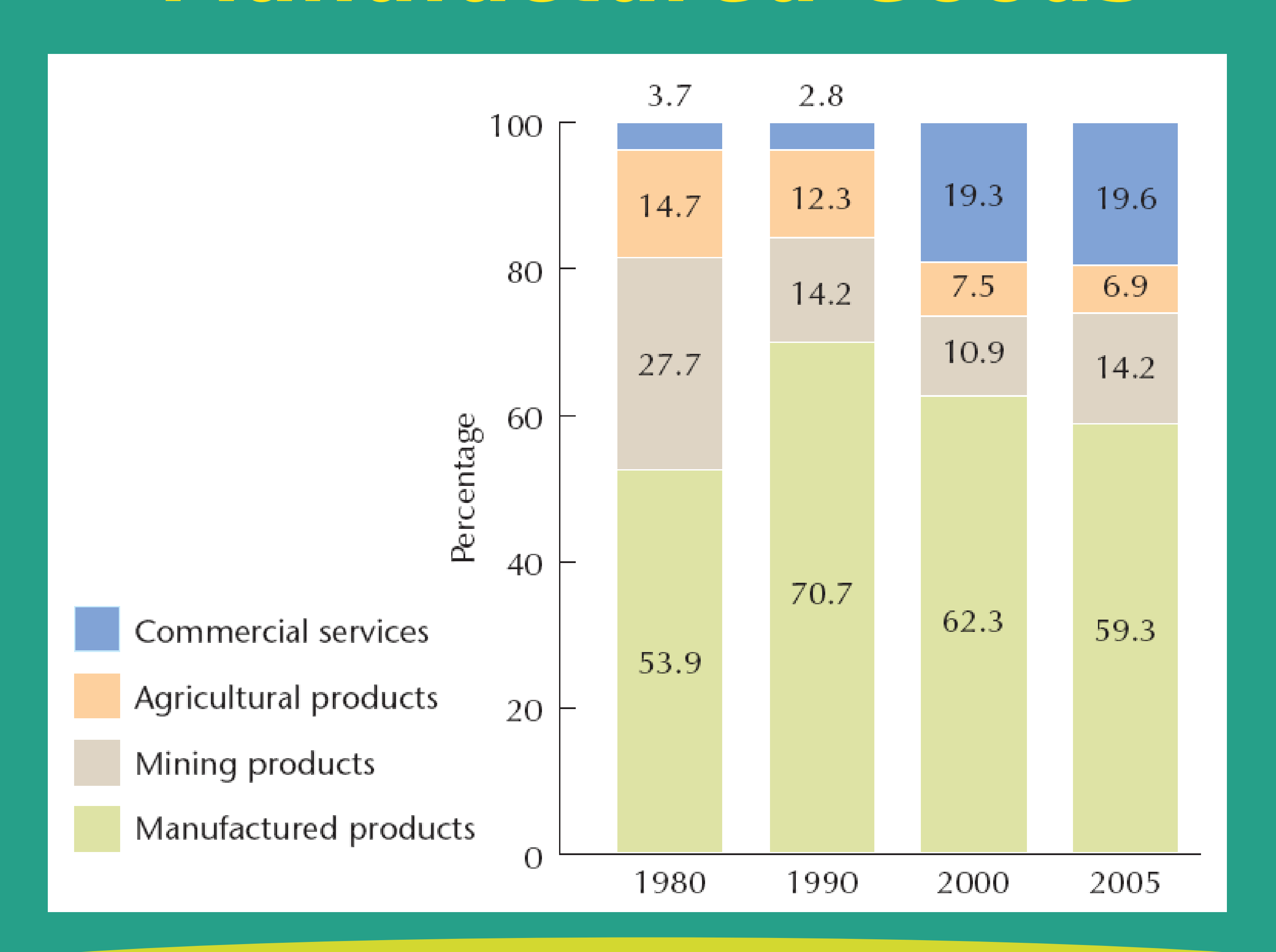
Theory Of Country Size

- Countries with large land areas are apt to have varied climates and natural resources
- They are generally more self-sufficient than smaller countries
- Large countries' production and market centers are more likely to be located at a greater distance from other countries, raising the transport costs of foreign trade

Factor-Proportions Theory

- A country’s relative endowments of land, labor, and capital will determine the relative costs of these factors
- Factor costs will determine which goods the country can produce most efficiently

Worldwide Trade of Major Manufactured Goods



Country-Similarity Theory

- Most trade today occurs among high-income countries because they share similar market segments and because they produce and consume so much more than emerging economies
- Much of the pattern of two-way trading partners may be explained by cultural similarity between the countries, political and economic agreements, and by the distance between them

Product Life Cycle (PLC) Theory

- Companies will manufacture products first in the countries in which they were researched and developed, almost always developed countries
- Over the product's life cycle, production will shift to foreign locations, especially to developing economies as the product reaches the stages of maturity and decline

Life Cycle of the International Product

LIFE CYCLE STAGE

	1: INTRODUCTION	2: GROWTH	3: MATURITY	4: DECLINE
Production location	• In innovating (usually industrial) country	• In innovating and other industrial countries	• Multiple countries	• Mainly in developing countries
Market location	• Mainly in innovating country, with some exports	• Mainly in industrial countries • Shift in export markets as foreign production replaces exports in some markets	• Growth in developing countries • Some decrease in industrial countries	• Mainly in developing countries • Some developing country exports
Competitive factors	• Near-monopoly position • Sales based on uniqueness rather than price • Evolving product characteristics	• Fast-growing demand • Number of competitors increases • Some competitors begin price cutting • Product becoming more standardized	• Overall stabilized demand • Number of competitors decreases • Price is very important, especially in developing countries	• Overall declining demand • Price is key weapon • Number of producers continues to decline
Production technology	• Short production runs • Evolving methods to coincide with product evolution • High labor input and labor skills relative to capital input	• Capital input increases • Methods more standardized	• Long production runs using high capital inputs • Highly standardized • Less labor skill needed	• Unskilled labor on mechanized long production runs

The Diamond of National Advantage

- Four conditions are important for competitive superiority:
  - demand conditions
  - factor conditions
  - related and supporting industries
  - firm strategy, structure, and rivalry

Limitations of the Diamond of National Advantage

- Domestic existence of all conditions:
  - Does not guarantee an industry will develop
  - Is not necessary with globalization

Factor Mobility Theory

Capital and labor move internationally to:

- Gain more income
- Flee adverse political situations

Effects of Factor Movements

- Factor movements alter factor endowments.
- Factor movements are substantial for many countries and insignificant for others.
- Although labor and capital are different production factors, they are intertwined.
- Pros and cons of outward and inward migration

The Relationship between Trade and Factor Mobility

- Capital and labor move internationally to gain more income and flee adverse political situations
- Although international mobility of production factors may be a substitute for trade, the mobility may stimulate trade through sales of components, equipment, and complementary products

Future: In What Direction Will Trade Winds Blow?

1. Displacement of jobs as developed countries shift production to more rapidly developing countries
2. Relationships among land, labor, and capital will continue to evolve
3. Continued trend toward a more finely tuned specialization of production among countries

Future: In What Direction Will Trade Winds Blow?

- Three factors could cause product trade to become less significant:
  - As economies grow, efficiencies of multiple production locations also grow because they can all gain sufficient economies of scale.
  - Small-scale production methods may enable countries to produce many goods efficiently for their own consumption.
  - Services are growing more rapidly than products as a portion of production and consumption within developed countries.